STANDARD & POOR'S

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Iowa; General Obligation

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Credit Profile		
Iowa ICR		
Long Term Rating	AAA/Stable	Affirmed

Rationale

In Standard & Poor's Ratings Services' opinion, the 'AAA' issuer credit rating (ICR) on Iowa reflects the state's:

- Diverse and stable economy;
- Good fiscal management, with a demonstrated willingness to restrain spending and make midyear corrections to maintain fiscal integrity;
- Strong financial operations with "rainy day" reserves built up to statutorily mandated levels;
- Good income levels; and
- Very low debt burden.

Iowa's population grew 5.4% during the 1990s to 2.93 million in 2000 and is currently estimated at slightly more than 3.0 million. About 14% of the state's population lives in Polk County (general obligation (GO) bonds rated 'AAA'), which includes the city of Des Moines (GO bonds rated 'AAA'), at the center of the state. We observe that the state's employment base is vulnerable to job losses in financial services and manufacturing, but jobs in education and health services are expected to grow. According to the U.S. Commerce Department's Bureau of Economic Analysis, Iowa's 2008 per capita personal income grew 5.1% year over year, to $36,680, which is 92% of the national level. Median household effective buying income is, in our opinion, good at 93% of the national level. The state's unemployment rate averaged 4.1% in 2008 (not seasonally adjusted) and edged up to 5.1% in April 2009. The national rate (seasonally adjusted) was 5.8% in 2008 and rose to 9.4% in April 2009.

Fiscal 2008 (year-end: June 30) ended with the general fund posting, on a budgetary basis, a $196.4 million general fund balance before transfers to the property tax credit, senior living trust, and reserve funds. The combined economic emergency and cash reserve fund balance increased to $592.4 million in 2008 from $535.1 million in 2007. Both funds are fully funded at their targeted levels as per state law. On an audited generally accepted accounting principles (GAAP) basis, the fiscal 2008 general fund balance increased $243.3 million to $2.3 billion (very strong, in our opinion, at 20.5% of expenditures), of which $1.1 billion (10%) is unreserved. Management tells us it projects that the GAAP fund balance will fall in 2009, to roughly $842 million.

The state's two most recent revenue forecasts, one in December 2008 and the other in March 2009, both revised fiscal 2009 tax receipts downward. We are told the December forecast was the basis for Gov. Chet Culver's recommended budget, which called for 1.5% across-the-board cuts to better align appropriations with the projected revenue trend. Management tells us that the legislature uses the March forecast to complete the budget. Overall, total fiscal 2009 tax receipts, before adjustments and accruals, are forecasted to total $6.6 billion, a 4.2% year-over-year increase. Net of adjustments, the state has $5.99 billion of available resources and $5.95 billion of appropriations. The state is projecting to increase its cash reserve fund to $465.2 million, in keeping with its target in that reserve fund. The 2009 budget is using $76.4 million of its economic emergency fund reserves for a transfer to the senior living trust fund ($20.4 million) and the flood relief program ($56 million), leaving $99 million in the fund, somewhat below the statutory targeted level, which is $155 million for the current fiscal year. However, with expenditures limited to 99% of budgeted revenues, and reserves set at 10% of adjusted revenues, we feel the state has safeguards in place that are likely to protect its long-term financial health.

Because Iowa is prohibited from issuing more than $250,000 in GO debt without voter approval, the state's capital requirements are met on a pay-as-you-go basis or with lease-backed issues. Of these outstanding lease issues, annual appropriated payments account for a low 1.2% of total governmental fund expenditures.

Outlook

The stable outlook reflects our expectation that the state, with the help of its good management practices, will maintain strong financial operations and strong rainy day reserves despite the challenges raised by the recession, which the state projects will weaken tax revenue performance. Although the state projects it will draw upon its reserves as a result of the economic downturn, we expect that the state will replenish them as per statutory mandate within a reasonable amount of time. The state's diverse economy also supports the outlook.

Economy

Iowa's economy is based on services, manufacturing, and agriculture. Although Iowa's economy faces challenges beyond those of the current recession, including labor shortages caused in part by the continued loss of young workers to out-of-state employers, the state continued to add jobs and attract new employers in 2008. According to IHS Global Insight, Iowa added 6,300 jobs to its employment base, or 0.4% job growth in 2008. In recent years, the state has become home to a number of financial and insurance companies, particularly in the Des Moines area, that diversify the economy. Iowa's financial services sector growth has slowed, however, due to the impact of the subprime mortgage crisis. It is notable that the Des Moines area is now the nation's second-largest insurance center, just behind Hartford, Conn., and IHS Global Insight ranks it as the third-largest in the world. A recent addition to the insurance base is Aviva, which recently selected West Des Moines as the site for its new U.S. headquarters. Fifteen percent of Iowa's nonfarm employment is in manufacturing- higher than the nation's 10% average. Manufacturing in Iowa is mainly in food, farm machinery products, and fabricated metals. Global Insight projects that all of Iowa's nonfarm employment sectors except education/health services will shed jobs in 2009, and job losses will trail into 2010. Global Insight considers Iowa's low business costs to be an economic growth driver, but that the state's labor shortages will be an impediment to future growth.

The state's 2008 real gross state product (GSP), which is an inflation-adjusted measure of the goods and services produced within the state, as reported by the U.S. Commerce Department's Bureau of Economic Analysis, grew 4.5% year-over-year, faster than the nation's 3.3% growth rate. Looking at the broader picture, the state's real GSP grew at an average annual rate of 5.3% from 2000-2008, slightly above the nation's 4.8% growth rate during that time. Meanwhile, total personal income grew 4.5% to $110.1 billion from 2000-2008, roughly on par with the nation's 4.6% growth rate for the same period.

Iowa is a major producer of corn, soybeans, and hogs. Iowa's farmers greatly benefit from the demand generated by ethanol producers, who purchase corn, and biodiesel fuel, produced from soybean oil.

2009 Budget Session

Iowa's original, $6.12 billion fiscal 2009 general fund budget was initially passed with an $85.5 million general fund surplus and without income or sales tax rate increases. The budget proposal was based on forecasted general fund net receipts growth of 2.0%. Since then, the budget has undergone midyear adjustments and two revenue forecast updates, in December 2008 and in March 2009. The final 2009 budget incorporates $6.6 billion in tax revenues, and, overall, $5.99 billion in total resources, net of transfers.

Total appropriations are $5.95 billion, and management expects an ending balance of $44.7 million, on a budgetary basis. The weakening revenue climate has prompted midyear, across-the-board cuts that trim $89.1 million of costs. Fiscal 2009 incorporates additional spending on education, health and human services, and justice compared with fiscal 2008 levels, but overall spending in 2009 is 1.5% lower than in 2008. There are $92 million of deappropriations in the budget, replaced with American Recovery and Reinvestment Act of 2009 (ARRA) funding ($111 million), to be used for school aid and Medicaid. The 2009 budget uses $49 million of reserves out of the economic emergency fund. The cash reserve fund is projected to close fiscal 2009 with a balance of $465.2 million, in alignment with the reserve target, and the economic emergency fund is projected to decrease to $99.1 million by the close of fiscal 2009 following $76.4 million in transfers out, mainly due to flood relief spending. This is somewhat below the statutory targeted level for this fund, which is $155 million for the current fiscal year.

The fiscal 2010 final budget was constructed based on the most recent revenue forecast released in March 2009, which calls for a 0.9% year-over-year decrease in tax receipts. Total tax revenues are projected to be $6.5 billion, and total resources (net of transfers) total $5.85 billion. Total appropriations are $5.8 billion, a 3.2% reduction compared with 2009 spending levels. The budget relies upon $256.2 million in ARRA funding, mainly in the areas of education and health and human services. After a period of growth, 2010 marks the first year the budget relies on the cash reserve fund to balance the general fund budget. The cash reserve fund will decrease by $123 million to $342.3 million in the final 2010 budget, which is $97 million below the state's targeted level for this fund. The economic emergency fund is budgeted to stay stable at $99 million, but this is $47.2 million below the target of $146.3 million for this fund.

Finances

In 1992, Iowa initiated several key financial reforms, including the institution of rainy day funds. The rainy day funds are made up of the cash reserve and economic emergency funds. Currently, the funding target for these funds is 7.5% of appropriations for the cash reserve fund and 2.5% for the economic emergency fund. As long as general fund revenues exceed or equal projections, a standing appropriation provides for the deposit of 1% of revenues into the rainy day funds, first into the cash reserve fund and then into the economic emergency fund. In addition, any general fund surpluses generated at the end of each fiscal year are transferred first into the cash reserve fund then into the economic emergency fund until the funding targets are hit. The rainy day reserves may only be spent for cash flow and budgetary emergency purposes. A three-fifths supermajority is needed to reduce the cash reserve fund below 3%.

These reserves allowed the state to cover operating deficits and provide cushion to help cover future revenue shortfalls. The cash reserve fund reached its statutorily targeted level of 7.5% of adjusted general fund revenues in fiscal 2006. The economic emergency fund reached its 2.5% targeted level in 2007. The combined economic emergency and cash reserve fund balance increased to $592.4 million in 2008 from $535.1 million in 2007. In 2008, the state reported $444.3 million in the cash reserve fund and $148.1 million in the economic emergency fund. The state is projecting to increase its cash reserve fund to $465.2 million in 2009, a level in keeping with that fund's target. The 2009 budget is using $76.4 million of its economic emergency fund reserves for a $20.4 million transfer to the senior living trust fund and $56 million for its flood relief program, leaving $99 million in the fund, somewhat below the statutory targeted level of $155 million for fiscal 2009. The 2010 budget calls for a cash reserve level of $342.3 million and economic emergency fund of $99.1 million, both levels being below target.

Iowa's policy to budget appropriations at just 99% of projected revenue was also instituted in 1992. To help keep the budget on target throughout the fiscal year, the state's revenue-estimating conference provides revenue projections four times a year--in July, September/October, December, and March/April. In recent years, the state moved to make midyear budget adjustments in reaction to reduced revenue forecasts from the revenue-estimating conference. We view the state's proactive approach to maintaining fiscal integrity by making the necessary cuts to sustain fiscal stability to be a major credit strength.

In 2001, Iowa issued $604 million of tax-exempt revenue bonds backed by 78% of the state's annual tobacco settlement payments through the Tobacco Settlement Authority, a public instrumentality and agency of the state. The bonds were refunded in 2005. Net proceeds from the series 2001 bonds were deposited into a special fund and reserved for health programs and certain other appropriations. Additional net proceeds from the authority's series 2005 bonds were deposited to another special fund and reserved for capital spending. In 2008, the legislature authorized the issuance of additional tobacco bonds secured by the state's remaining settlement payments share.

Financial Management Assessment: 'Good'

The state's financial and budgetary management practices are considered to be "good" under Standard & Poor's Financial Management Assessment (FMA). An FMA of good indicates that practices exist in most areas, although not all may be formalized or regularly monitored by governance officials. Practices include revenue projections done four times a year by the state's Revenue Estimating Conference; monthly budgetary reconciliations with monthly reports to the legislature regarding year-to-date revenues and expenditures; and five-year financial projections done by the state's budget office, updated annually. The state does not have a multiple year capital plan at this time, but may implement one in the near future. State statutes regarding investments are supplemented by a written state treasurer's policy. Because the state does not have GO debt outstanding, it does not have a debt management policy at this time. State law requires the maintenance of two rainy day funds--the cash reserve fund, targeted at 7.5% of adjusted general fund revenues for the current fiscal year, and the economic emergency fund, which is targeted at 2.5%.

Debt And Pensions

Iowa has no GO debt outstanding. Under the Iowa Constitution, the state is prohibited from issuing more than $250,000 in GO debt without the electorate's approval. Previously, the state issued lease-backed debt to provide funds for jail construction and a statewide fiber-optic network. The state has historically funded additional general capital needs through general operations. A dedicated motor fuel sales tax pays for capital programs for state highways.

In 2000, the state authorized the issuance of bonds backed by its moral obligation to fund two programs that were set up to improve local infrastructure. The "Vision Iowa" program authorized the sale of bonds to fund state and local cultural and recreational attractions, $146.5 million of which were outstanding at the end of fiscal 2008. The state also issued bonds authorized by the Iowa school infrastructure program to provide matching infrastructure grants to schools, $32.7 million of which were outstanding in 2008. State gaming and lottery revenues secure both bonds, which are additionally secured by the state's moral obligation pledge to replenish debt service reserve funds. In 2009, the state authorized the Iowa Jobs Program (IJOBS) and bonding to fund the program. The main purpose of the program is to serve as a catalyst for job creation, infrastructure investment, and community rebuilding as a result of the damage caused by weather-related damage, including flooding, in 2008.

The state's debt burden, including capital leases, agency debt, moral obligation debt, debt issued for the Honey Creek State Park project, and the $591 million IJOBS program, totals roughly $920 million in principal currently outstanding, which we feel is low at $307 per capita. During the 2008 legislative session, lawmakers approved the issuance of $131 million of bonds backed by the state's moral obligation to build a new maximum security prison. We understand the state plans to issue a portion of this debt in 2009.

Most of the state's employees are covered by the Iowa Public Employees' Retirement System (IPERS), which is a multiemployer defined benefit pension system. As of June 30, 2008, covered employees contribute 3.9% of their pay and the state as employer contributes another 6.05%. The system's unfunded liability increased by $39 million to $2.66 billion (from $2.27 billion in 2007) at fiscal year-end June 30, 2008. In 2008, the actuarial value of the plan's net assets rose 5.3% year-over-year to $21.86 billion, resulting in a funded ratio of 89%. The plan's ratio has ranged from 90%-88% for the past three years.

The state does not pay for health care benefits for retirees, who are allowed on their own to buy into the same health insurance that covers active employees. The state, however, under Governmental Accounting Standards Board Statement 45, reports a liability for its retiree health care benefits due to the implied subsidy that is deemed to exist when retired workers pay the same for health insurance as younger active workers. According to an actuarial study done for the state in 2008, the state's unfunded actuarial accrued liability was $184.7 million.

Related Research

USPF Criteria: "GO Debt," Oct. 12, 2006